



**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

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Order Instituting Rulemaking to Implement
the Commission's Procurement Incentive
Framework and to Examine the Integration
of Greenhouse Gas Emissions Standards into
Procurement Policies.

R.06-04-009

**PREHEARING CONFERENCE STATEMENT OF
CONSTELLATION NEWENERGY, INC.,
CONSTELLATION ENERGY COMMODITIES GROUP, INC. AND
CONSTELLATION GENERATION GROUP, LLC
IN R06-04-009, PHASE 2**

November 15, 2006

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I. Introduction and Summary

On November 1, 2006, Administrative Law Judges Turkeurst and Lakritz issued a Joint Administrative Law Judges' Ruling and Notice of Prehearing Conference ("PHC Ruling") to be held on November 28, 2006. The PHC Ruling directs interested parties to submit PHC statements that address Phase 2 scoping issues, procedural and scheduling issues, and the integration of the load-based greenhouse gas ("GHG") emissions cap under development in this proceeding with the implementation of the measures contained in the recently enacted Assembly Bill 32 – the California Global Warming Solutions Act of 2006 ("AB 32").

California's political leadership and regulators have asserted a willingness and intent to provide national leadership in this vital area of environmental improvement with their greenhouse gas emission reduction actions to date. While acknowledging that the ultimate success of efforts to reduce greenhouse gases will require regional, national, and quite likely, global commitment to such reductions, California is nevertheless at the forefront of providing the

national roadmap.¹ California's efforts in this area remain dynamic, and even more so, given the potential to see regional and national efforts relatively soon. It is against this backdrop, and an understanding that efforts around AB 32 will be both dynamic and very demanding, that Constellation provides these comments.

As an initial implementation matter, if a load-based program is pursued the Commission should acknowledge that a "one size fits all" approach is not feasible or desirable. There are legitimate, fundamental distinctions between public utilities and ESP/CCAs that need to be recognized in program design. Similarly, there are significant complexities associated with attributing 1990 "baseline" GHG emission levels for ESPs/CCAs since those types of entities obviously did not exist at that time. Moreover, flexible compliance approaches that include the broadest and most flexible market-based compliance tools will be a critical design element to keep program compliance costs economic and to maximize the ability to create a liquid market for emissions reductions.

Of paramount concern to Constellation is that three distinct forums addressing greenhouse emission reduction issues are currently underway – (1) this Commission proceeding (Phase 2) to implement a load-based greenhouse emissions cap; (2) the earlier Commission proceeding (Phase 1) that is awaiting a Commission decision on an interim GHG emissions performance standard ("EPS") implementing SB 1368; and (3) the nascent efforts to be supervised by California Air Resources Board ("CARB") to implement AB 32. Each of these efforts in turn requires carefully coordinated work among numerous agencies and governing bodies, as well as ensuring a means for timely input and due process for various stakeholders and energy market participants. The multiple venues have and will continue to require extensive

¹ Section 38501(d) of AB 32 states: "National and international actions are necessary to fully address the issue of global warming. However, action taken by California to reduce emissions of greenhouse gases will have far-reaching effects by encouraging other states, the federal government, and other countries to act."

time and effort from the Commission, Commission Staff, stakeholders, and myriad of other agencies and government officials.

Thus, Constellation strongly endorses the PHC Ruling's recognition that significant attention must be paid to ensure that the work in these multiple venues is carefully coordinated and integrated. How this coordination and integration will be achieved is the seminal issue for this proceeding. Such upfront clarity will not only to bring efficiency to the exploration and resolution of complicated issues, but more importantly, clarity will ensure that duplicative and/or conflicting standards, excessive reporting requirements, or other unintended outcomes do not occur that would thwart achieving the common goal of greenhouse gas emission reduction.

In order to promote a high degree of coordinated efforts, Constellation suggests that the following threshold questions must be addressed at the outset in this phase of the proceeding:

1. Because D.06-02-032 was issued prior to the significant statutory efforts led by the Governor and Legislature were adopted, the Commission should examine whether the complex work associated with development of a load-based cap is complementary to or potentially conflicting with the potential source-focus efforts of AB 32. It is not apparent to Constellation that the Governor's vision for a cap and trade focused on emission sources will be complemented by development of a separate and distinct load-side effort by the CPUC. Accordingly, a threshold question arises as to whether the Phase 2 effort should be refocused to better dovetail with the AB 32 approach;
2. Analysis and adoption of flexible compliance mechanisms – especially those such as source-based cap and trade programs that can be operated over wider regional or national geographic areas from a variety of emission sources – hold the key to

successful long term and economically viable emission reductions. Constellation believes that evaluation and adoption of market-based compliance mechanisms should be assigned the highest possible priority. Accordingly, a threshold question arises as to whether California's efforts under AB 32, and other, similar efforts in other states or internationally (as well as the potential for such programs on a national level), are compatible and complementary to the load-based approach contemplated for development in Phase 2, and how or if the CPUC program would be phased out if a broader regional or national program is developed;

3. Under AB 32, a wide variety of emitting resources will be required to report greenhouse gas emissions. Under a load-based cap, emissions reporting will be required of LSEs, although the nature and scope of that reporting is an open issue. The interim EPS, contemplated and under SB 1368, and awaiting adoption by the Commission, will contain another measure of emissions-related compliance by dictating GHG emissions characteristics of long-term supply commitments by LSEs. Steps must be taken to eliminate duplicative reporting requirements or potential inconsistencies between reports for the same resources by different entities (sources vs. LSEs) by pursuing a common reporting platform that can provide demonstrated efficiencies. Accordingly, a threshold question arises as to whether the *reporting approach* contemplated in Phase 2 is the same as, or distinct from, emissions reporting contemplated under AB 32.
4. How will emission reduction requirements potentially imposed on emitting resources pursuant to AB 32 avoid double counting with the emission reductions

that that Load Serving Entities (“LSEs”) must achieve under either the load-based cap to be developed in Phase 2, or the interim EPS implementing SB 1368?

Accordingly, a threshold question arises as to whether these *emissions reductions mechanisms* are complementary or conflicting, and whether it will be straightforward to verify compliance with both.

5. If the CPUC’s emission reduction program creates a market value for GHG reductions relative only to the emissions associated with services provided by LSEs to their customers (as distinct from the broader emission reduction market that can be envisioned based on AB 32), then how can the Commission ensure that these markets interact in a constructive manner? Are the market signals associated with the emissions reduction requirements imposed on different entities (i.e., the AB 32 mechanisms focused on sources of emissions vs. the CPUC’s Phase 2 load-based emission reduction program’s focus on emissions attributed to LSEs’ service to customers) clear or impaired, and do those signals encourage economically efficient emission reduction efforts? Put another way, a threshold question arises as to whether the Phase 2 program will potentially segment a larger GHG emissions reduction market structure that should evolve from AB 32 as to undermine overall efficiency.

Constellation agrees, except as noted in the section below, that the scoping questions contained in Attachment A, are the right ones to be addressing in this proceeding presuming that the threshold questions raised above suggest that pursuit of a load-based mechanism is advisable in light of the other significant efforts on source-based programs. Finally, in the last section of these comments, Constellation provides comment on the proposed procedural schedule.

II. Prehearing Conference Statement

A. *Comments on Attachment A Scoping Questions.*

As noted above, for the most part, Constellation agrees with the scope of questions included in Attachment A to the PHC Ruling, with the exceptions referenced below:

1. Phase 2 Issue Areas

Scoping Issue 1) Establish GHG emissions reporting standards and requirements, including treatment of GHG emissions from non-specific resource contracts. Explore with CCAR and CARB ways in which protocols may need to be modified or further developed to include generation/facility-specific data to fit within a load-based cap.

Comment: Constellation believes that this question should be addressed as a priority issue along with the threshold questions that are described in the introduction. Constellation would urge the Commission to conduct the review of its existing policies in light of the passage of AB 32 at the outset of this proceeding, in order for the proceeding to be conducted most efficiently. It is important to avoid the potential for conflicting or mixed regulatory and market signals. As noted in the threshold questions, the Commission's load-based program seeks to drive reductions from entities different from source-based AB 32 program approach. Clarity is need both as to how these two approaches would likely interact, and as to whether the regulatory and market signals from dual approaches will be the most effective means to realize the desired reductions.

Scoping Issue 2) In conjunction with work in issue area #1 above:

- (a) Establish a date by which all power purchase agreements that PG&E, SDG&E and SCE sign must include a provision requiring supplier registration or other mandatory reporting of carbon emissions, and
- (b) Develop a method for assigning emissions values to supplies that are unregistered.

Comment: Constellation does not believe that is necessary for the IOUs' contracts to include a provision requiring supplier registration or other mandatory reporting of carbon emissions. Such a requirement will undoubtedly be duplicative of requirements that are imposed directly on suppliers when such reporting becomes mandatory, as required under AB32. An additional burden on the IOUs to account for proper registration by suppliers is unwarranted, will ultimately be duplicative, may lead to unnecessary market confusion. Thus Constellation believes that 2(a) should be deleted from the scope of this proceeding.

With respect to 2(b), Constellation asks whether the focus on "unregistered" sources essentially translates to mean only "out of state" resources in light of AB 32. If that is the case, then the Commission should be wary of certain interstate commerce concerns that regulation focused solely on out-of-state resources triggers. Those concerns would potentially be addressed should a broader, regional program be pursued.

Scoping Issue 3) Establish the GHG emissions baseline for each LSE.

Comment: This issue touches on threshold issues noted above. Constellation recognizes the need to establish the 1990 emissions baseline in order to determine the target emission level to be achieved by 2020. However, it is not clear what relevance an emissions baseline *for each LSE* will have. There are undoubtedly some LSEs now, such as the ESP respondents to this proceeding, that were not in business in 1990, just as it is likely that some retail customers who were served by specific LSEs in 1990 are now served by another LSE. Therefore, the purpose to be served by attempting to establish the baseline *for each LSE* is uncertain, and seems to ultimately require a potentially complex customer-specific (or class-specific) baseline determination to address new LSEs and load migration issues. Because of uncertainties associated with the load-based approach, Constellation reserves the right to comment further when the objectives for LSE-specific baseline determination is better understood and the threshold questions are clarified.

Scoping Issue 4) Establish GHG emission reduction requirements over time for LSEs as a whole and for each individual LSE, relative to the baseline.

Comment: As noted above, Constellation does not have a clear enough picture of the purpose for an LSE-specific reduction requirement and believes that it may lead to an unnecessarily complex program. Indeed, the concept of LSE-specific reductions seems somewhat antithetical in a retail choice market environment, where customer migration alone would cause the emissions associated with an ESP's load to change. Ultimately, any LSE's GHG profile will be tied to its customer base and the resources used to serve that particular mix of customers. To the extent customers can migrate between providers, how would adjustments in baseline occur (absent assigning a "baseline" to customers)? Constellation, therefore, again reserves comment on whether the determination of LSE-specific baselines is the appropriate approach for this proceeding pending clarification of issues noted in the threshold questions.

Scoping Issue 5) Establish and administer a process for allocating emission allowances.

Comment: Emission allowance allocation is another issue that can be better addressed by Constellation once the threshold questions noted above are addressed. For example, it is not apparent how such an allowance would be made to LSEs, as opposed to resources. Furthermore, if an LSE-based approach is pursued, Constellation believes that incorporating flexible, market based compliance mechanisms may be better achieved if tradable allowances are auctioned rather than allocated, with subsequent trading in a secondary market. Constellation, therefore, again reserves comment on whether this is an appropriate for this proceeding pending clarification of issues noted in the threshold questions.

Scoping Issues 6) Evaluate and consider various flexible compliance mechanisms, including but not limited to, multi-year compliance periods, early action credits, banking provisions, in-state and out-of-state trading options, and emission offsets, among others.

Comment: As noted in the introductory comments and its threshold questions, Constellation believes that the evaluation and adoption of market-based, flexible compliance mechanisms

focused at the resource level will provide the key to long term, economically viable emissions reduction, and thus this issue should be given the highest possible priority by the Commission and CARB in their respective jurisdictions. It is critical that the broadest range of emissions sources be eligible to participate in the program so that there is a viable pool for reductions supporting flexible, market-based compliance tools. That said, Constellation's preference is to see a single market focused at the resource driving the value of GHG reductions with little segmentation between sectors (i.e., electric generation vs. other sources). A broad approach focused at the emission source level would make for a stronger and clearer market signal on the value of GHG reductions (CO₂ equivalent basis) as opposed to split market segments or dual reduction requirements (one on sources, and on LSEs on a load basis).

Scoping Issue 7) Consider whether a GHG emissions performance standard should be adopted as a permanent complement to a load-based GHG emissions cap and, if so, the design of such a standard.

Comment: During Phase 1 of this proceeding regarding development of an interim EPS to further the implementation of SB 1368, Constellation expressed concern that adoption of an interim EPS would detract from the development of a longer term emission reductions mechanism, such as a cap and trade program. Now that both AB 32 and SB 1368 have been enacted, there is yet another layer of complexity surrounding the analysis and adoption of new load-based emission reduction requirements and regulations contemplated by the Commission in Phase 2. In order to provide clear regulation and associated price signals, Constellation strongly urges the Commission to avoid overlapping and potentially conflicting regulatory requirements or programs. By responding to the threshold questions presented above and adopting a clear objective that the emission reduction mechanisms adopted in Phase 2 must cleanly integrate and complement implementation of AB 32, the Commission can ensure that those source-based reduction mechanisms can replace the interim EPS. Such clarity now will allow both the Commission and stakeholders to focus on work at hand in Phase 2 unfettered by another layer of integration and complexity that will occur if the EPS compliance must also be made compatible with both Phase 2 and the AB 32 implementation measures.

Scoping Issue 8) Evaluate the cost effectiveness of the most promising flexible compliance options. Develop appropriate scenario analysis for this purpose.

Comment: Constellation agrees that metrics to determine the promising flexible compliance options will be needed, but cannot speculate on cost-effectiveness at this point without more clarity on program interactions. Constellation needs to reserve comment on this issue pending clarification of issues noted above in the threshold questions.

Scoping Issue 9) Develop appropriate performance incentives and penalties. Explore the concept of allowance sale incentives, consistent with the direction in D.06-02-032, and with AB 32 implementation.

Comment: Constellation agrees that the development of performance incentive and penalties that will apply to all entities subject to the emission reduction requirements should be developed in this proceeding. However, Constellation cannot speculate on the appropriate approaches at

this point without more clarity on program interactions. Constellation reserves comment on this issue pending clarification of the threshold questions.

Scoping Issue 10) Address how energy service providers and community choice aggregators, as well as small and multi-jurisdictional utilities, should be included under the load-based cap incentive framework. In particular, per D.06-02-032, identify where these energy service providers, community choice aggregators and utilities should be subject to the same terms and conditions of GHG reduction requirements and associated caps, and where differences may be appropriate. Address how to coordinate the Commission regulated energy sector program with one that may be contemplated for the non-Commission regulated load serving entities, such as municipal utilities.

Comment: As noted in the threshold questions, Constellation is not clear how a load-based emission reductions program would be designed without ultimately resulting in added complexity to impute GHG emissions profiles to specific customers or customer classes. This would entail significant complexity that may otherwise be avoided by focusing the state's GHG emission reduction efforts at sources, as contemplated under AB 32. The interim EPS, once adopted, will apply to all longer-term resource procurement efforts by both public utility and non-public utility LSPs, (but exclude municipal utilities). Once a source-based reduction mechanism is in place, there is little reason to have overlapping programs. However, to the extent that the focus remains on a load-based emissions reduction program rather than source reductions, Constellation believes that the fundamental differences between the utility LSEs and non-utility LSEs, such as ESPs and CCAs, must be taken into consideration when designing a compliance program.

Scoping Issue 11) Define the steps to take to ensure that GHG emissions associated with customer use of natural gas are incorporated into a procurement incentive framework for the future.

Comment: Constellation cannot comment on this issue at this time. It appears to contemplate customer-specific baseline quantities, or a fuel consumption-based GHG program, rather than an LSE focused program.

Specific Questions Regarding Reporting Requirements:

Constellation appreciates the questions presented regarding reporting requirements, but cannot provide detailed responses prior to additional clarity on the threshold questions presented in these comments. Specifically, AB 32 and other GHG reduction efforts focus primarily on source reporting structures, including certain programs in other areas that track emissions associated with electric generation at the grid level (i.e., source to sink). A common, uniform reporting platform is a critical link to a well designed program. It is not apparent to

Constellation how a load-based reporting requirement on LSEs would dovetail or interact with a source-based reporting mechanism, but that interaction is very important to avoid conflicts and confusion in terms of program compliance and verification of its efficacy. Accordingly, constellation cannot comment on the reporting requirements at this time.

Question a) How accurate are the LSEs' current emissions estimates, including emissions associated with imported power and non-unit-specific power contracts? What, if any, reporting or accounting improvements are needed to ensure that emissions reported reflect actual emissions associated with LSE load in order to implement a load-based cap and trade program?

Comment: Constellation believes the focus here should be on source emission reporting under AB 32 through a common mechanism that looks at grid-level transactions between source and sink like a registry mechanism, rather than LSE's estimation of those emissions. As noted in the threshold questions, having two sources of reporting on essentially the same emissions will likely lead to confusion and complexities that would be best avoided by focusing on reductions at the source.

Question b) What information is needed to account for the emissions characteristics of the Department of Water Resources power contracts?

Comment: To the extent the DWR power contracts are unit specific, the information needed to account for the emissions characteristics should be based on the actual operation of the unit. For DWR contracts that are not unit specific, the non-unit specific metrics that are applied to other non-unit specific contracts should be equivalently applicable to the non-unit specific DWR contracts. These issues were addressed in Phase 1 relative to the EPS.

Question c) What information is needed to account for the emissions characteristics of liquidated damages contracts generally?

Comment: This issue was addressed generally in Phase 1. LD contract emission estimation would not be necessary if there is regional source emission reporting. In terms of estimation, the ability to estimate essentially turns on the ability to identify the likely marginal generation resource relied upon to provide the energy and the fuel such resources use. Estimation should vary by season and time of day since hydroelectric production and availability can influence the marginal resource.

Question d) What improvements should be made to improve the accuracy of LSE emissions reporting, especially as it relates to non-unit-specific power contracts?

Comment: As noted in the threshold questions, LSE load-based emission reporting raises questions about customer-based emissions estimation, since customer load can migrate between LSEs and because differing customer load profiles can impute different mixes of resources (with differing efficiencies). More precision on emissions, and in turn emissions reductions, can occur

by focusing on the reporting requirement on the emission sources themselves, rather than the entities that purchase energy and capacity from the market to serve customer loads.

Question e) If the Commission adopts CCAR’s reporting protocols, will modifications be needed to allow for facility-based registration and reporting for entities who sell power to LSEs? If so, how would facility-based reporting address entities who do not offer unit-specific contracts? What other options would provide the Commission with independently verified emissions values and estimates for LSE contracted power?

Comment: Constellation continues to believe that sustainable emission reductions can be best achieved by requiring emitting resources to meet specific emission standards and then providing flexible compliance mechanism, such as cap and trade and offsets programs, to allow higher emitting resources to manage their overall compliance. As noted in the threshold questions, this source-based approach is more direct and more easily monitored and verified than an approach that turns on estimates of an LSEs past and current emissions. Where an LSE contracts for energy on a non-specific basis, the energy production ultimately delivered can likely be identified after the fact based on imports or other schedules through a grid-based accounting protocol, with default values for non-specific contracts if such accounting is not feasible or easily done. If there are regional or national uniform reporting requirements, the emissions associated with particular energy production can be quantified at the source and conveyed over to the buyer.

Question f) What emissions information should be included in LSE procurement contracts? And how should this information be verified?

Comment: Assuming passage of the EPS, LSEs will seek assurances in contracts that the resource does not exceed the EPS gateway threshold. Other emission information would be available through project-specific supply information gathered through a grid-level accounting mechanism, or extrapolated from information provided to the CEC or CAISO, primarily the heat rate derived from production and fuel consumption. Therefore, data sources directly from generation resources would be the best avenue for accurate data, as opposed to requiring LSEs to demand the data and funnel it back to the CPUC.

Question g) In the absence of independent verification of resource-specific or contract specific emissions values, or in order to deter inappropriate “contract shuffling,” should a default emissions factor be assigned at the value of coal for any non-renewable supplies of electricity with fossil fuel emissions? Or should the emissions value be assigned at an average portfolio level such as the CEC Net System Power Average or some other level?

Comment: In light of its threshold questions regarding the load-based program, and the prior discussion in Phase 1, Constellation cannot specifically comment, other than to say that it is more efficient to require the reporting either directly from the resources, preferably from a grid-based accounting approach, or to use the supply data provided to the CEC or the resource characteristics provided to CAISO. Moreover, unless a contract is clear that it covers the full capacity of a generation resource, it is not clear that any precise emissions level can be verified for a specific contract. This would be the case where the unit is dispatched at different load levels depending on its market commitments, with varying heat rates along the production curve,

and hence varying GHG emissions at different operating points. It would not be possible, therefore, to accurately predict likely emissions from an energy call option or block energy purchase from a partial unit.

Question h) What modifications or updates should be made to existing emission factors and estimates, if any? Are the estimates used by CCAR the best estimates available? Are they adequate to support a load-based cap? If improvements are needed, how can they be accomplished in the near term?

Comment: As noted in the threshold questions, Constellation is not clear how the load-based cap and LSE-specific emissions estimates are to be done without estimating emissions based on customers' demand profiles. This will be a complex task, and it is not clear that it will be sufficient to support a load-based cap. Instead, focus should be made on the resource-specific emission reporting.

Question i) What are the prospects for a region-wide generation attribute tracking system? What work should be done in California and, if appropriate, elsewhere to support a multi-state approach to this issue?

Comment: As noted in the threshold questions, Constellation believes that significant changes have occurred with the Governor's and Legislature's efforts related to AB 32 and SB 1368, as well as other international and state efforts. In light of the recent change in control of Congress, it appears more likely that nation-level changes could occur, distinct from changes individual states may pursue. Constellation would urge the Commission to look at source-based emission reporting and determination issues, including the efficiency that can be gained from a grid-based accounting approach, to advance how the AB 32 effort for generation emissions determinations will be done. Any multi-state or regional effort will need to have a uniform means of determining emissions from various sources.

B. Other Issues

Constellation must reserve comment on the need for evidentiary hearings at this time.

Once additional clarification is made relative to the desirability of pursuing LSE-specific load based cap in light of the threshold questions, the need for hearings may become clearer.

Constellation does support the use of workshops and comments to address policy-related issues.

III. Conclusion

Constellation appreciates the Commission's efforts, but believes that the threshold questions it has presented in these comments should be addressed soon so that there is clarity on how a load-based GHG reduction program would be coordinated with a source-based reporting

and emission reduction program. Constellation supports a regional and national GHG program because of the significant efficiencies that can be gained through a uniform reporting process, including a grid-based accounting process that tracks emissions from source to sink. Once the direction of the Commission's efforts are clear in light of those GHG program developments that have occurred since February 2006, Constellation can better comment on particular issues raised in the PHC Ruling. In any event, any program designed by the Commission must provide for a flexible, market-based compliance approach that appropriately reflects the fundamental distinctions between public utilities and ESPs/CCAs, and which encourages the broadest possible range of emission reduction sources.

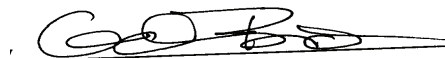
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Certificate of Service

I hereby certify that I have this day served a copy of “Prehearing Conference Statement Of Constellation NewEnergy, Inc., Constellation Energy Commodities Group, Inc. And Constellation Generation Group, LLC, In R.06-04-009, Phase 2” on all known parties to R.06-04-009 by transmitting an e-mail message with the document attached to each party named in the official service list. Parties without e-mail addresses were mailed a properly addressed copy by first-class mail with postage prepaid.

Executed on November 15, 2006 at Sacramento, California

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